

under a defined benefit plan, the applicable plan years are all plan years that begin on or after the regulatory effective date, as set forth in § 1.401(l)-6(b), or, in the case of governmental plans, as set forth in § 1.401(a)(4)-13(b).

(vi) *Transition rule for defined contribution plans.* A defined contribution plan is deemed to satisfy the cumulative permitted disparity limit for the first plan year to which these regulations apply, as set forth in § 1.401(l)-6(b), or, in the case of governmental plans, as set forth in § 1.401(a)(4)-13(b).

(2) *Cumulative disparity fraction.* An employee's cumulative disparity fraction is the sum of the employee's total annual disparity fractions, as defined in paragraph (b)(2) of this section, attributable to the employee's total years of service under all plans.

(3) *Determination of total annual disparity fractions for prior years.* For each of the employee's years of service credited as of the end of the last plan year beginning before January 1, 1989, not to exceed 35, under all plans as of that time that are taken into account under paragraph (a)(3) of this section (whether or not terminated), the employee's total annual disparity fraction is one. Therefore, if, before the first plan year beginning on or after January 1, 1989, an employee never participated in or benefited under any plan taken into account under paragraph (a)(3) of this section, the employee's total annual disparity fractions are determined without regard to this paragraph (c)(3). An employer may apply the rule in this paragraph (c)(3) with respect to all employees, using a year (including the current year) that is chosen by the employer and is later than 1989. Thus, for example, in lieu of calculating annual disparity fractions for all plan years, the employer may assume that the full disparity limit has been used in each prior plan year for which an employee has been credited with a year of service.

(4) *Special rules for greater of formulas and offset arrangements—(i) Greater of formulas—(A) In general.* A defined benefit plan that is a section 401(l) plan and that provides a benefit equal to the greater of the benefits determined under two or more formulas is deemed to satisfy the cumulative permitted

disparity limit with respect to an employee if each of the requirements in paragraphs (c)(4)(i) (B) and (C) of this section is satisfied. For this purpose, a plan that uses a fresh-start formula that determines the accrued benefit as the greater of two amounts under § 1.401(a)(4)-13(c)(4) (ii) or (iii) provides a benefit equal to the greater of the benefits determined under two or more formulas.

(B) *Separate satisfaction by formulas.* Each formula under the plan would satisfy the cumulative permitted disparity limit if it were the only formula under the plan. In the case of a current formula that applies to the employee's total years of service (as, for example, under § 1.401(a)(4)-13(c)(4) (ii)(B) or (iii)(B)), for purposes of determining whether that formula would satisfy the cumulative permitted disparity limit if it were the only formula under the plan, the special rule for prior years under paragraph (c)(3) of this section may be disregarded.

(C) *Single plan.* The employee has never benefited under another plan taken into account under paragraph (a)(3) of this section that is a section 401(l) plan or that satisfies section 401(a)(4) by relying on § 1.401(a)(4)-7. For this purpose, if the benefit under the plan is offset in an offset arrangement described in paragraph (b)(8)(iii)(B) of this section, the other plan is disregarded. In addition, a plan does not fail the requirements of this paragraph (c)(4)(i)(C) merely because the employee benefits under another defined benefit plan, provided that—

(1) With respect to each benefit formula under the plan, no years of service taken into account under that benefit formula are taken into account under a benefit formula of the other plan; and

(2) Paragraph (c)(4)(i)(B) of this section would be satisfied if the plans were treated as a single plan that provided a benefit equal to the greater of the benefits provided under two or more formulas. For this purpose, a formula consists of the sum of a formula for the years of service taken into account under one plan and a formula for the years of service taken into account under the other plan. Thus, each possible combination of the formulas

under the plans must satisfy paragraph (c)(4)(i)(B) of this section.

(ii) *Offset arrangements*—(A) *In general.* If a defined benefit plan is a section 401(l) plan and the benefit under the plan (the gross benefit plan) is offset by the benefit under another plan (the offsetting plan) in an offset arrangement described in paragraph (b)(8)(iii)(B) of this section, the gross benefit plan is deemed to satisfy the cumulative permitted disparity limit with respect to an employee if each of the requirements in paragraphs (c)(4)(ii) (B) and (C) of this section is satisfied.

(B) *Separate satisfaction by plans.* This requirement is satisfied if the gross benefit plan would satisfy the cumulative disparity limit if no offset applied, and the offsetting plan satisfies the cumulative permitted disparity limit, not taking into account the gross benefit plan.

(C) *No other plan.* Except for the plans in the offset arrangement, the employee has never benefited under another plan taken into account under paragraph (a)(3) of this section that is a section 401(l) plan or that satisfies section 401(a)(4) by relying on § 1.401(a)(4)-7. An offset arrangement does not fail the requirements of this paragraph (c)(4)(ii)(C) merely because the employee benefits under another defined benefit plan, provided no years of service taken into account under a benefit formula of any plan in the offset arrangement are also taken into account under a benefit formula of the other plan.

(5) *Examples.* The following examples illustrate this paragraph (c). In each example the plan is noncontributory and, unless provided otherwise, is the only plan ever maintained by the employer. Each plan uses a normal retirement age of 65 and contains no provision that would require a reduction in the 0.75-percent factor under § 1.401(l)-3(b)(2) or (3). Each example discusses the benefit formula applicable to an employee who has a social security retirement age of 65.

Example 1. Plan M is a defined benefit excess plan that provides a normal retirement benefit of 1 percent of average annual compensation up to covered compensation, plus 1.75 percent of average annual compensation

above covered compensation, for each year of service without limit. The disparity provided under the plan for the plan year is 0.75 percent, the excess benefit percentage of 1.75 percent minus the base benefit percentage of 1 percent. The maximum excess allowance for the plan year is 0.75 percent. Thus, each employee's annual defined benefit excess plan disparity fraction under the plan for each plan year is one. Because the plan contains no limit on the years of service taken into account under the plan, the sum of the total annual disparity fractions for a potential employee with more than 35 years of service will exceed 35. In addition, the plan does not provide that the overall permitted disparity limits may not be exceeded as required by paragraph (a)(2) of this section. The plan therefore does not satisfy the cumulative permitted disparity limit of this paragraph (c).

Example 2. Plan N is an offset plan that provides a normal retirement benefit of 2 percent of average annual compensation, minus 0.75 percent of final average compensation up to the lesser of covered compensation and average annual compensation, for each year of service up to 35. The disparity provided under the plan for the plan year is 0.75 percent, the offset percentage. The maximum offset allowance for the plan year is 0.75 percent. Thus, each employee's annual offset plan disparity fraction under the plan for each plan year is one. Because the plan limits the years of service taken into account under the plan to 35, the sum of the total annual disparity fractions for an employee cannot exceed 35. The plan therefore satisfies the cumulative permitted disparity limit of this paragraph (c).

Example 3. Plan O is a defined benefit excess plan that provides a normal retirement benefit of 0.75 percent of average annual compensation up to covered compensation, plus 1.25 percent of average annual compensation above covered compensation, for each year of service up to 45. The disparity provided under the plan for the plan year is 0.5 percent, the excess benefit percentage of 1.25 percent minus the base benefit percentage of 0.75 percent. The maximum excess allowance for the plan year is 0.75 percent. Thus, each employee's annual defined benefit excess plan disparity fraction under the plan for each plan year is 0.67 (0.5 percent divided by 0.75 percent). Because the plan limits the years of service taken into account under the plan to 45, the sum of the total annual disparity fractions for an employee cannot exceed 30 (0.67 x 45). The plan therefore satisfies the cumulative permitted disparity limit of this paragraph (c).

Example 4. (a) Plan P is a defined contribution excess plan. Plan P provides a base contribution percentage of 6 percent and an excess contribution percentage of 11.7 percent, thus providing disparity of 5.7 percent for

the plan year. Because the maximum excess allowance for each plan year under Plan P is 5.7 percent, each employee's annual defined contribution plan disparity fraction under Plan P for each plan year is one. Plan Q is a defined benefit excess plan maintained by the same employer. Plan Q provides a base benefit percentage of 1 percent and an excess benefit percentage of 1.75 percent for each year of service up to 35, thus providing disparity of 0.75 percent for the plan year. Because the maximum excess allowance for each plan year under Plan Q is 0.75 percent, each employee's annual defined benefit excess plan disparity fraction under Plan Q for each plan year is one.

(b) Employee A benefits under Plan P for the 1980 through the 1994 plan years. The sum of Employee A's total annual disparity fractions under Plan P is 15. (Under paragraph (c)(3)(i) of this section, Employee A's annual disparity fraction for each year of service as of the end of the 1988 plan year is one.) As of the 1995 plan year, Employee A no longer benefits under Plan P and begins to benefit under Plan Q for the first time. In order to satisfy the cumulative permitted disparity limit of this paragraph (c), Plan Q must provide that no disparity will be provided if the sum of an employee's total annual disparity fractions reaches 35, taking into account the employee's annual defined contribution plan disparity fractions under Plan P as well as the employee's annual defined benefit excess plan disparity fractions under Plan Q. Thus, after Employee A has benefited under Plan Q for 20 years, Plan Q may not provide any disparity in additional benefits accrued for Employee A.

Example 5. (a) Plan O is a noncontributory defined benefit excess plan. Plan O provides an employee whose social security retirement age is 65 with the greater of the benefits determined under two formulas. The first formula provides a benefit of 1 percent of average annual compensation up to covered compensation, plus 1.75 percent of average annual compensation above covered compensation, for each year of service up to 35. The second formula provides a benefit of 1 percent of average annual compensation up to covered compensation, plus 1.6 percent of average annual compensation above covered compensation, for each year of service up to 40.

(b) Under paragraph (b)(4) of this section, an employee's annual defined benefit excess plan fraction for each of the 35 years under the first formula is $0.75/0.75$ or one, and an employee's annual defined benefit excess plan fraction for each of the 40 years under the second formula is $0.6/0.75$ or 0.8. Under paragraph (b)(8)(ii) of this section, an employee's annual defined benefit excess plan fraction (and total annual disparity fraction because the employee benefits only under Plan O) for the plan year is the larger frac-

tion under the two formulas or one. Therefore, after 35 years, the employee has a cumulative disparity fraction of 35. The disparity provided under the second formula for years of service after 35 thus exceeds the cumulative permitted disparity limit unless the plan qualifies for the special rule in paragraph (c)(4)(i) of this section.

(c) Assume the condition in paragraph (c)(4)(i)(C) of this section is satisfied because no employee has benefited under another plan taken into account under paragraph (a)(3) of this section. In addition, the largest cumulative disparity fraction possible under the first formula is 35 times one or 35, and the largest cumulative disparity fraction possible under the second formula is 40 times 0.8 or 32. Thus, the requirement of paragraph (c)(4)(i)(B) of this section is also satisfied because each formula would satisfy the cumulative permitted disparity limit if it were the only formula under the plan. Under paragraph (c)(4)(i) of this section, the plan is deemed to satisfy the cumulative permitted disparity limit with respect to an employee whose social security retirement age is 65.

(d) *Additional rules.* The Commissioner may prescribe additional rules under this section as the Commissioner considers appropriate. Additional rules may include (without being limited to) rules for computing the fractions described in this section with respect to terminated plans, rules for applying the overall permitted disparity limits to employees who benefit under plans maintained by railroad employers, and rules for determining which plans do not satisfy section 401(l) if the overall permitted disparity limits are exceeded.

[T.D. 8359, 56 FR 47634, Sept. 19, 1991; 57 FR 10819, 10952, Mar. 31, 1992, as amended by T.D. 8486, 58 FR 46833, Sept. 3, 1993]

§ 1.401(l)-6 Effective dates and transition rules.

(a) *Statutory effective date*—(1) *In general.* Except as otherwise provided in paragraph (a)(2) of this section, section 401(a)(5)(C) is effective for plan years beginning on or after January 1, 1989, and section 401(l) is effective with respect to plan years, and benefits attributable to plan years, beginning on or after January 1, 1989. The preceding sentence is applicable to a plan without regard to whether the plan was in existence as of a particular date.

(2) *Collectively bargained plans.* (i) In the case of a plan maintained pursuant

to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, sections 401(a)(5) and 401(l) are applicable for plan years beginning on or after the later of—

(A) January 1, 1989; or

(B) The date on which the last of such collective bargaining agreements terminates (determined without regard to any extension of any such agreement occurring on or after March 1, 1986). However, notwithstanding the preceding sentence, sections 401(a)(5) and 401(l) apply to plans described in this paragraph (a)(2) no later than the first plan year beginning after January 1, 1991.

(ii) For purposes of paragraph (a)(2)(i)(B) of this section, a change made after October 22, 1986, in the terms or conditions of a collectively bargained plan, pursuant to a collective bargaining agreement ratified before March 1, 1986, is not treated as a change in the terms and conditions of the plan.

(iii) In the case of a collectively bargained plan described in paragraph (a)(2)(i) of this section, if the date in paragraph (a)(2)(i)(B) of this section precedes November 15, 1988, then the date in this paragraph (a)(2) is replaced with the date on which the last of any collective bargaining agreements in effect on November 15, 1988, terminates, provided that the plan complies during this period with a reasonable good faith interpretation of section 401(l).

(iv) Whether a plan is maintained pursuant to a collective bargaining agreement is determined under the principles applied under section 1017(c) of the Employee Retirement Income Security Act of 1974. See H.R. Rep. No. 1280, 93d Cong., 2d Sess. 266 (1974). In addition, a plan is not treated as maintained under a collective bargaining agreement unless the employee representatives satisfy section 7701(a)(46) of the Internal Revenue Code after March 31, 1984. See § 301.7701-17T of this chapter for other requirements for a plan to be considered to be collectively bargained.

(b) *Regulatory effective date*—(1) *In general.* Except as otherwise provided in paragraph (b)(2) of this section,

§§ 1.401(l)-1 through 1.401(l)-6 apply to plan years beginning on or after January 1, 1994.

(2) *Plans of tax-exempt organizations.* In the case of plans maintained by an organization exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans), §§ 1.401(l)-1 through 1.401(l)-6 apply to plan years beginning on or after January 1, 1996.

(3) *Defined contribution plans.* A defined contribution plan satisfies section 401(l) with respect to a plan year beginning on or after the effective date of these regulations, as set forth in paragraphs (b)(1) and (b)(2) of this section, if it satisfies the applicable requirements of §§ 1.401(l)-1 through 1.401(l)-5 for the plan year.

(4) *Defined benefit plans.* A defined benefit excess plan or offset plan satisfies section 401(l) with respect to all plan years, and benefits attributable to all plan years, beginning on or after the effective date of these regulations, as set forth in paragraphs (b)(1) and (b)(2) of this section, by satisfying the applicable requirements of §§ 1.401(l)-1 through 1.401(l)-5 and the requirements of § 1.401(a)(4)-13(c) (and § 1.401(a)(4)-13(d), if applicable), using a fresh-start date that is on or after December 31, 1988, and before the effective date of these regulations. A defined benefit excess plan or offset plan that does not satisfy section 401(l) with respect to all plan years beginning on or after the effective date of these regulations may, under the rules of § 1.401(a)(4)-13(c) (and § 1.401(a)(4)-13(d), if applicable), satisfy section 401(l) for plan years beginning after a fresh-start date by satisfying the applicable requirements of §§ 1.401(l)-1 through 1.401(l)-5 after the fresh-start date.

(c) *Compliance during transition period.* For plan years beginning on or after January 1, 1989, and before the effective date of these regulations, as set forth in paragraph (b) of this section, a plan must be operated in accordance with a reasonable, good faith interpretation of section 401(l). Whether a plan is operated in accordance with a reasonable, good faith interpretation of section 401(l) will generally be determined based on all of the relevant facts and circumstances, including the extent to

which an employer has resolved unclear issues in its favor. A plan will be deemed to be operated in accordance with a reasonable, good faith interpretation of section 401(*J*) if it is operated in accordance with the terms of §§ 1.401(*J*)-1 through 1.401(*J*)-5.

[T.D. 8486, 58 FR 46835, Sept. 3, 1993]

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§ 1.401(m)-1 Employee and matching contributions.

(a) General Rules—(1) *Nondiscriminatory amount of contributions.* A defined contribution plan does not satisfy section 401(a)(4) for a plan year unless the amount of employee and matching contributions to the plan for the plan year satisfies section 401(a)(4). See § 1.401(a)(4)-1(b)(2)(ii). Except as specifically provided otherwise, for plan years beginning after December 31, 1986 (or such later date provided in paragraph (g) of this section) the amount of employee and matching contributions

under a plan satisfies the requirements of section 401(a)(4) only if the employee and matching contributions under the plan satisfy the actual contribution percentage test of section 401(m)(2) and paragraph (b) of this section. See § 1.401(a)(4)-1(b)(2)(ii)(B). Also, except as specifically provided otherwise, for plan years beginning after December 31, 1988 (or such later date provided in § 1.401(m)-2(d)), the amount of employee and matching contributions under a plan satisfies the requirements of sections 401(m) and 401(a)(4) only if any multiple use of the alternative methods of compliance with sections 401 (k) and (m) (contained in sections 401(k)(3)(A)(ii)(II) and 401(m)(2)(A)(ii), respectively) is corrected under § 1.401(m)-2(c). See section 401(m)(9) and § 1.401(m)-2. For these purposes, the employee and matching contributions are combined with the elective and qualified nonelective contributions, if any, that are treated as matching contributions, and the recharacterized elective contributions, if any, that are treated as employee contributions for purposes of section 401(m).

(2) *Other nondiscrimination rules.* Nondiscrimination requirements in addition to those described in paragraph (a)(1) of this section apply to employee and matching contributions under sections 401(a)(4) and 410(b). For example, under section 401(a)(4) a plan may not discriminate with respect to the availability of benefits, rights, and features under the plan. See § 1.401(a)(4)-1(b)(3). The right to make each level of employee contributions, and the right to each level of matching contributions, are benefits, rights, or features subject to this requirement, and each level must therefore generally be available to a group of employees that satisfies section 410(b). See § 1.401(a)(4)-4(e)(3) (i) and (iii) (F) through (G). Thus, for example, a plan does not satisfy section 401(a)(4) if it provides a higher rate of matching contributions for highly compensated employees than for non-highly compensated employees. See paragraph (e)(4) of this section for rules relating to the application of section 401(a)(4) to the correction of excess aggregate contributions. See § 1.401(a)(4)-11(g)(3)(vii) for special rules relating to